



### COMMISSIONER'S COMMENTS

By G. Edward Leary, Commissioner

At the close of business on Friday, June 25, 2004, the department took possession of the Bank of Ephraim in Ephraim, Utah. As only a soldier or sailor who has fought in a war dislikes war, so regulators dislike taking possession of a depository institution. Taking possession of a depository institution in a very legal sense means that all efforts short of a possessory action would not adequately protect the interests of the institution's depositors or members. Once the department received court approval to take possession and did so, we appointed the FDIC receiver. The FDIC conducted a bidding process for the right to acquire the insured deposits. Far West Bank, a state-chartered bank headquartered in Provo, Utah won the right to acquire the insured deposits of the Bank of Ephraim and opened two

former branch offices as branches of Far West the next day and the main office on the following Monday.

We took possession of Bank of Ephraim in order to protect depositors and the public, finding, among other things, that the Bank of Ephraim was insolvent due to embezzlement by a former bank employee. The Bank of Ephraim was also critically short on liquidity and had been experiencing persistent asset quality concerns which alone had warranted supervisory action. The department as well as the Federal Reserve Bank of San Francisco had been closely monitoring the Bank of Ephraim and had ordered it to increase its capital to a safe and sound level. Efforts by the bank in a very short time period to raise shareholders equity to an acceptable level were unsuccessful.

The Bank of Ephraim was chartered in 1905 by the State of Utah and had two offices in Ephraim, one office in Mount Pleasant, and an additional office in Hildale, Utah. At the time of closure, Bank of Ephraim had total deposits of approximately \$45 million, in about 9,000 accounts. The Hildale office did not reopen with customers being advised to visit the Far West branch in St. George.

The department acknowledges and thanks those banks who bid on the insured deposits, with a special *thank you* to Far West Bank for stepping in and helping to quickly restore the depositors' and customers' banking services.

The Bank of Ephraim was the first bank failure in Utah since Tracy Collins Bank, Salt Lake City, failed on December 31, 1988.

This unfortunate incident coupled with an employee defalcation at Utah Copper Credit Union last year should cause all depository institutions to review their internal control policies and procedures and ensure that adequate and proper separation of duties is evident in all operations. The vital role of an internal auditor to the safe and sound operation of a depository institution has never been clearer.~

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## **CHIEFLY SPEAKING**

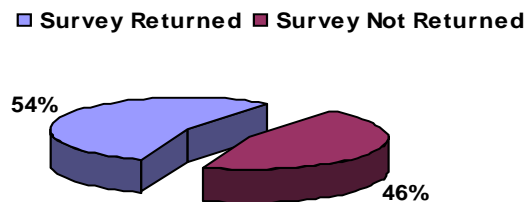
By Michael Jones, Chief Examiner

### Quality Assurance Survey Results for 2003

For regular readers of the Networth News, you may recall my second quarter of 2003's article discussing the Department's implementation of a post-examination survey. For new readers, I will present a quick summary and would refer you to last year's Networth News article for a more detailed discussion of the Department's objectives and efforts concerning our post-examination survey.

Beginning in January of 2003, a survey was sent with each Report of Examination produced by the Department. We refer to it as our Quality Assurance Survey. The survey asked for an evaluation by management of the examined depository institution in 19 areas. Each area, from the clarity of the examination entry letter to the ease, accuracy, and understandability of the report, asked for management's assessment on a scale from "1" (strongly agree/excellent) to "5" (strongly disagree/poor). Anonymity of a respondent's identity is maintained by using numbered surveys, with the numbering log tightly controlled by the Commissioner's Administrative Assistant. Each survey has an area where comments and feedback can be given. There is also an optional section where management can identify their institution and indicate if any follow-up contact is needed

In 2003, 85 Quality Assurance surveys were sent. Assessments from the completed surveys were reviewed, analyzed, and tabulated. Comments were read and discussed amongst Department personnel and follow-up contacts were made where it was so indicated. Here is a summary of the results of our 2003 Quality Assurance surveys.



**Figure 1**

Surveys, by their general nature, are not viewed positively. Because they require time to complete and return, response rates are typically low. The Department's response rate for 2003 was remarkably good. Surveys were returned for 46 of the 85 Quality Assurance surveys that were sent out; a response rate of 54 percent.

Of the surveys returned, 72 percent of the respondents identified themselves on the survey and 26 percent of the respondents provided narrative comments along with their survey assessments.

Feedback on the 2003 Quality Assurance surveys was generally favorable, as demonstrated in Table 1. On a scale of 1 to 5, the aggregate average rating on the 19 numerical questions covered on the survey was 1.43. The most favorable ratings received were on question #5, the effectiveness of the Examiner-in-Charge in communicating examination findings, and question #7, the professionalism of Department personnel. The least favorable ratings were received on question #3, the length of time used to conduct the examination, and question #8, the accuracy of the report in reflecting the practices and condition of the institution. A breakdown of each survey question and the assessments given is presented in Figure 2.

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**Application Activity Report**  
Utah Department of Financial Institutions  
*For quarter ending June 30, 2004*

<b>Branch Approval</b>	<b>Address</b>	<b>Received</b>	<b>Status</b>
Credit Union One	1773 West North Temple, SLC UT	11/7/03	Approved 11/17/03
Horizon Credit Union	37 East 100 North, Kaysville UT	12/12/03	Approved 12/18/03
Far West Bank	822 S SR 198, Payson UT	12/12/03	Approved 1/8/04
Moroni Feed Credit Union	420 S Main, Gunnison UT	1/30/04	Approved 2/3/04
Transportation Alliance Bank	1605 E Saddleback Blvd, Ogden	3/1/04	Approved 6/18/04
Pacific Horizon Credit Union		6/8/04	Accepted 6/18/04
<b>Branch Discontinuance</b>	<b>Address</b>	<b>Received</b>	<b>Status</b>
Far West Bank	586 N Main, Payson UT	5/12/04	Approved 5/25/04
<b>Relocations</b>	<b>Address</b>	<b>Received</b>	<b>Status</b>
Health Care Credit Union	from Central Office to 36 S State, SLC	1/27/04	Relocated 5/15/04
America West Bank	from 1010 N Hillfield Rd, Layton to 476 W Heritage Blvd, Layton	3/19/04	Approved 4/20/04
CIT Bank	from 2855 E Cottonwood Pkwy to 2180 S 1300 E #250, SLC	3/24/04	Approved 4/21/04
Kings Peak Credit Union	from 333 E 200 N, Roosevelt to 57 N 1000 E, Roosevelt	6/10/04	Approved 6/18/04
<b>De Novo Charter</b>	<b>Address</b>	<b>Received</b>	<b>Status</b>
Goldman Sachs Bank USA	295 Chipeta Way Salt Lake City UT	7/3/02	FDIC Approved 7/21/03 Extended on 3/3/04
ComData	500 N Market Place Dr. #250 Centerville UT	8/18/03	Approved 12/19/03
Target Bank	299 S Main Suite 1300 Salt Lake City UT	12/31/03	Accepted 12/31/03 Time suspended 3/9/04
GMAC Automotive Bank		2/13/04	Accepted 4/8/04

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Field of Membership Expansion	Amend Bylaws to Include	Received	Status
Credit Union One	to add employees of Modern Display	3/4/04	Approved 4/14/04
Salt Lake County CU	to add residents of Salt Lake County	5/14/04	Accepted 5/19/04
<b>Mergers or Acquisitions</b>		<b>Received</b>	<b>Status</b>
Southwest Industrial Area CU into Beehive Credit Union		4/13/04	Approved 5/3/04 Effective 6/30/04
Twin Cities JACL CU into National JACL CU		5/17/04	Approved 6/7/04 Effective 6/30/04
<b>Loan Production Office</b>		<b>Received</b>	<b>Status</b>
Bank of the West	503 N 400 W, Salt Lake City	5/19/04	Approved 6/1/04
America West Bank	3340 Harrison Blvd, Ogden	5/18/04	Approved 6/1/04

## Regulation B – Equal Credit Opportunity Act

By Eva Rees, Compliance Supervisor

The Equal Credit Opportunity Act (Reg. B) requires that lenders treat applicants equally. According to Reg. B, "The purpose of this regulation is to promote the availability of credit to all creditworthy applicants without regard to *race, color, religion, national origin, sex, marital status, or age (provided the applicant has the capacity to contract); to the fact that all or part of the applicant's income derives from a public assistance program; or to the fact that the applicant has in good faith exercised any right under the Consumer Credit Protection Act.*"

Under Reg. B., there are three types of lending discrimination. They are Overt Evidence of Discrimination, Evidence of Disparate Treatment, and Evidence of Disparate Impact.

As our compliance specialists go out to the depository institutions on compliance examinations, they are running across some troubling situations. The one we will be

discussing today is the practice of adjusting an applicant's debt-to-income ratio when the applicant has no housing expense.

We have seen occasional instances where, because the applicant lives at home and has no housing expense, the lending institution, as a matter of policy, adds an arbitrary housing expense amount to the applicant's monthly debts. This appears to meet the definition of discrimination under the Evidence of Disparate Impact.

Under this treatment, the debt-to-income ratio will be inflated by adding this arbitrary amount to their debts. For example:

<u>With arbitrary housing expense:</u>		<u>Without:</u>
Loan	\$300	\$300
Housing	\$300	\$0
Income	\$1,000	\$1000
Debt/Income	60%	30%
	<u>*denied</u>	<u>*approved</u>
<u>*Loan policy – debt/income ratio not to exceed 45%</u>		

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**Table 1**

Questions	Highest Assessment	Lowest Assessment	Average Assessment
1. The entry letter instructions were clear and concise on what items to submit for the examination.	1	3	1.49
2. The institution was provided enough lead-time to meet the examination entry letter's request of items.	1	3	1.33
3. The length of time used to conduct the examination was appropriate.	1	5	1.72
4. The appropriate level of contact with management was maintained.	1	3	1.46
5. The Examiner-in-Charge was effective in communicating examination findings.	1	3	1.28
6. The examination was conducted with little disruption to employees and with sensitivity to ongoing business operations.	1	5	1.5
7. DFI personnel conducted themselves in a courteous and professional manner.	1	4	1.28
8. The Report accurately portrayed your institution's practices and conditions.	1	4	1.52
9. The Report was easy to read and understand.	1	3	1.30
10. Overall, I was satisfied with the examination process.	1	3	1.37
11. Evaluate the effectiveness of DFI examiners in performing the examination in the following key areas:			
a. Overall Condition	1	2	1.42
b. Capital Adequacy	1	3	1.31
c. Asset Quality	1	3	1.35
d. Reserve of Loan Loss	1	3	1.50
e. Management	1	3	1.40
f. Earnings	1	3	1.51
g. Liquidity	1	3	1.40
h. Internal Operations	1	3	1.51
i. Sensitivity	1	4	1.47

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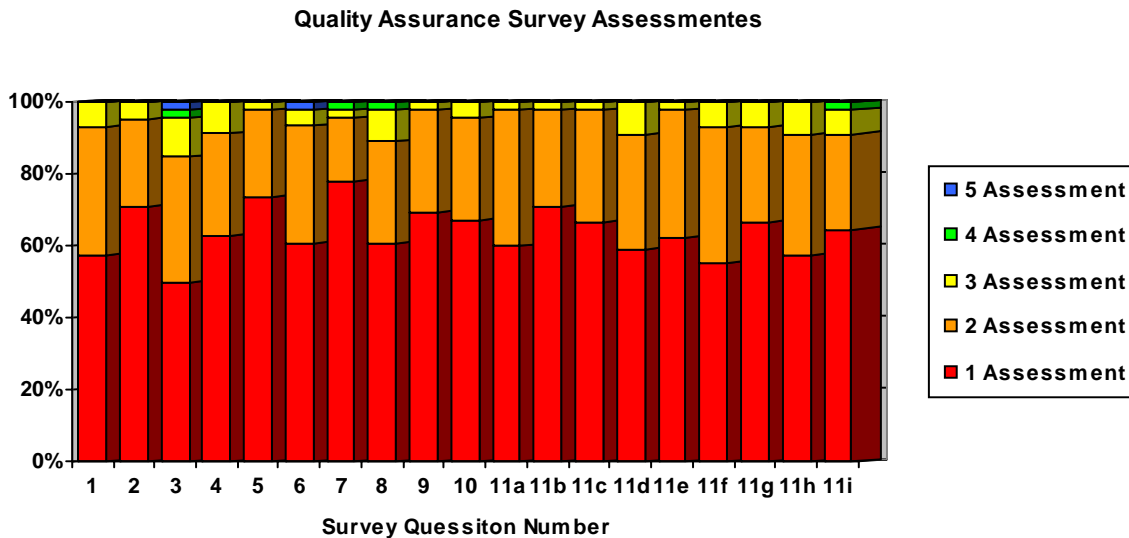
Since this loan applicant does not actually owe the \$300 per month housing expense, and is typically a young borrower who still lives at home, they would unfairly be denied this loan on a prohibited basis – *age*.

We have heard the argument that the addition of an arbitrary amount for housing expense is done because of a “business necessity” which is allowed under Reg. B. However, according to the “Fair Lending Examination Procedures” of the federal agencies, “the justification [for “business necessity”] must be manifest and may not be hypothetical or speculative.”

Since adding an arbitrary amount for housing expense would be both “hypothetical and speculative,” lending institutions under our jurisdiction will be criticized in the Report of Examination if found engaging in this practice.

There will be more to come in the next Networth News regarding Reg. B and spousal signatures.~

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**Figure 2**

The Department would like to thank those who took the time to complete a Quality Assurance survey in 2003. We especially appreciate those who provided us with narrative comments. We take the survey assessments and comments seriously and will strive to improve the Department's performance based upon the feedback we receive.

We anticipate continuing our post-examination survey program through the next several years. It will take a couple of years before we will be able to establish any favorable or adverse trends. Look for a survey with your next Report of Examination.~

## INDIRECT LENDING CAUTION

By Orla Beth Peck, Supervisor of Credit Unions

In recent weeks I have received information indicating that salesmen at two different dealerships have falsified, or helped buyers falsify, the documentation sent to financial institutions in order to obtain approval for indirect auto financing. In most of the cases an altered credit bureau report was submitted listing the credit history of an individual with good credit in place of the actual credit report for the individual applying for the loan. In some cases, an altered pay stub was submitted to falsify income.

It appears that faxed information is particularly vulnerable to manipulation. It is possible to white-out old information and type in new; photocopy the altered document and then fax the photocopy. If done carefully, the alteration is hard to detect.

It is recommended that financial institutions engaging in indirect auto lending institute a procedure to spot check the information they receive from the dealer by pulling their own credit reports and independently verifying income.~